

Supreme Court, U. S.  
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In the  
**Supreme Court of the United States**  
OCTOBER TERM, 1978

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No. 77-1359

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UNITED STATES OF AMERICA,

*Petitioner,*

*v.*

KIMBELL FOODS, INC., *et al*,

*Respondents.*

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ON WRIT OF CERTIORARI TO THE UNITED STATES  
COURT OF APPEALS FOR THE FIFTH CIRCUIT

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BRIEF FOR KIMBELL FOODS, INC.

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**ON WRIT OF CERTIORARI TO THE UNITED STATES  
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**BRIEF FOR KIMBELL FOODS, INC.**

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**QUESTION PRESENTED**

Whether a private contractual lien, created and perfected under state law, may be defeated by a junior private contractual lien, created and perfected under the same state law, by virtue of its subsequent assignment to an agency of the federal government?

**STATEMENT**

This case involves the relative priorities of two competing contractual security interests duly created and perfected under the UCC of Texas. The first party, Kimbell Foods,

Inc., ("Kimbell"), had duly acquired and perfected its security interest in accordance with state law in the collateral before the second party, Republic National Bank of Dallas, ("Republic"), had even acquired, much less perfected, a security interest in the same collateral. Over four years after Kimbell had first duly perfected its security interest, the SBA became a creditor of O. K. Super Markets, (the Debtor), and was at that point correspondingly assigned a portion of Republic's security interest. Under the Texas Uniform Commercial Code, the security interest granted Kimbell is clearly superior to the security interest granted Republic which was subsequently assigned to the SBA.

Kimbell, a grocery wholesaler, supplied inventory to O. K. on a weekly basis. In addition, in 1966 and 1968 Kimbell extended credit to O. K. evidenced by two promissory notes. In connection with the foregoing, O. K. and Kimbell entered into three separate security agreements. The first security agreement was executed in August, 1966, while the other two were executed in, respectively, April and November, 1968. In each of these security agreements O. K. granted Kimbell a security interest in certain grocery store equipment and fixtures and in "[a]ll goods, wares and merchandise and any and all additions or accessions thereto" which were located at specified locations. This collateral secured O.K.'s obligations to Kimbell under both notes as well as "all other indebtedness at any time hereafter owing by Debtor to Secured Party" including O. K.'s obligations to Kimbell for future inventory advances.

In September, 1966, and in April and November, 1968, Kimbell duly filed financing statements and the underlying security agreements with the office of the Texas Secretary of State. Under the Uniform Commercial Code as adopted

in Texas, this gave Kimbell a fully perfected security interest in the collateral which was senior to the interests of all other secured parties and lien creditors. In addition, it made the exact terms of the security agreements, including the future advance and after acquired property clauses, a matter of public record.

Subsequently, in February, 1969, O. K. obtained a \$300,000.00 loan from Republic. This loan was secured by all of O. K.'s "machinery, fixtures, equipment and inventory, now existing or hereafter acquired" located at certain specific addresses, including those already covered by the Kimbell security agreements. Republic filed a financing statement with the Texas Secretary of State on February 18, 1969.

When Republic made its loan to O. K., Republic was aware that Kimbell held a senior security interest on certain of O. K.'s assets. Republic insisted that O. K. pay off all senior secured debts, but O. K. paid Kimbell only the remaining balance under the notes, leaving an outstanding balance of \$18,390.93 for inventory purchases. No request was made that Kimbell file any termination statements or releases of its financing statements.

At the time O. K. sought the loan from Republic, both Republic and O. K. applied to the SBA for a guaranty of Republic's prospective loan to O. K. In connection therewith, Republic was required to submit to the SBA all relevant credit information on O. K. and on the collateral for the loan, including the nature of Kimbell's security interest in certain of O. K.'s assets. In addition, the SBA conducted its own appraisal of O. K.'s assets.

In January, 1969, the SBA agreed to guaranty 90% of Republic's loan to O. K. Neither at the time the SBA issued its guaranty to Republic, nor at the time Republic made its

loan to O. K., did the SBA advance any funds to O. K. or Republic. In 1969 the SBA therefore was not a secured party with an interest in the collateral, but was a guarantor with a contingent claim against O. K. No reference to the SBA guaranty appeared in Republic's security agreement or financing agreement or financing statement (App. 67-69).

For approximately two years thereafter, Kimbell continued to supply inventory to O. K. in reliance upon Kimbell's senior security interest, as determined by the respective filings of Kimbell and Republic with the office of the Texas Secretary of State. After January 15, 1971, however, Kimbell ceased supplying O. K. with inventory and received no further payments from O. K. At this time, just as at all times in preceding years, Kimbell's security interest was certain in all respects: Kimbell's identity as a secured party was a matter of public record, the identity of the collateral was fixed, and the amount of Kimbell's claim was liquidated.

Three weeks later, on February 3, 1971, O. K. and Republic agreed to a sale of all the assets of O. K. located at three of O. K.'s stores, with the proceeds of such sale to be held in escrow by Republic pending resolution of competing claims to such fund. This agreement was approved by the SBA and Kimbell. Subsequently, the contents of the three stores were sold for an aggregate purchase price of \$95,000.00.

Also on February 3, 1971, the SBA honored its guaranty and paid \$252,331.93 to Republic, which amount represented 90% of O. K.'s then outstanding indebtedness to Republic. This was the first time that SBA funds were advanced in connection with Republic's loan to O. K. As such, the SBA, up to this time a contingent unsecured creditor, acquired an interest in the loan through the purchase of the note held by Republic.

On February 4, 1972, Kimbell obtained a judgment in state court against O. K. in the amount of \$24,445.37. This represented the exact amount of the O.K.'s principal indebtedness to Kimbell (\$18,258.57), plus interest (\$1,186.80) and attorneys' fees (\$5,000.00). Kimbell then filed the present suit in the United States District Court for the Northern District of Texas seeking a declaration that its security interest in certain of O. K.'s property created a claim to the escrow fund which was senior to the claims of Republic and the SBA, and asking for judgment against Republic as escrowee.

The United States District Court found Kimbell's security interest inferior to that of the SBA, and Kimbell appealed the District Court ruling to the Circuit Court of Appeals for the Fifth Circuit which court reversed the District Court. Subsequently the United States petitioned this court for a writ of certiorari, which writ was granted.

## ARGUMENT

### I. THE APPELLATE COURT WAS CORRECT IN HOLDING THE CHOATE LIEN DOCTRINE INAPPLICABLE IN DETERMINING THE PRIORITY OF KIMBELL FOODS' SECURITY INTEREST

#### A. *The Policies and Circumstances Which the Choate Lien Doctrine is Applicable to Are Not Present in This Instance*

The choate lien doctrine had its genesis in decisions involving the application of the federal insolvency priority statute, (R.S. 3466, now 31 U.S.C. 191) to federal tax liens. *New York v. MaClay*, 288 U.S. 290, *United States v. Texas*, 314 U.S. 480, *United States v. Waddill, Holland & Flinn, Inc.*, 323 U.S. 353, *United States v. Gilbert Associates, Inc.*, 345 U.S. 361.

The doctrine was extended in *United States v. Security Trust & Savings Bank*, 340 U.S. 47 to determine the priority of a federal tax lien arising outside the context of the federal insolvency priority statute, and was subsequently applied in similar circumstances to a miscellany of statutory liens. *United States v. City of New Britain*, 347 U.S. 81, *United States v. Acri*, 348 U.S. 211, *United States v. White Bear Brewing Company*, 350 U.S. 1010, *United States v. Liverpool & London Insurance Co.*, 348 U.S. 215, *United States v. Colotta*, 350 U.S. 808, *United States v. Vorreiter*, 355 U.S. 15, *United States v. Vermont*, 377 U.S. 351, *U. S. v. Equitable Life Assurance Society of the United States*, 384 U.S. 323.

The government in its brief identifies the underlying policy of the federal insolvency priority statute to be "... securing an adequate revenue to sustain the public burthens and discharge the public debts", and recognizes that the development of the choate lien doctrine within the context of the federal insolvency priority statute was to secure those broad revenues (Petitioner's brief page 17).

In *United States v. Security Trust & Savings Bank*, 340 U.S. 47, this court analogizes the purpose of the federal insolvency priority statute to the purpose of federal tax liens and concludes that a rule similar to the rule for determining priorities in the context of the federal insolvency priority statute must also prevail in the area of federal tax liens (340 U.S. at 51).

Tax revenues contribute overwhelmingly to the general treasury fund which funds the expenses incurred by government in exercising both its constitutional and non-constitutional functions. The continued existence of the sovereign is dependent upon its ability to lay and collect taxes.

The choate lien doctrine was extended to the area of federal tax liens in recognition of these paramount policies,

to insure that the power of the sovereign to lay and collect taxes is unimpeded. No such policy considerations are here present.

The government attempts to equate Small Business Administration revenues with tax revenues (Petitioner's brief page 22), and analogize Small Business Administration lending activities to a constitutional function of government (Petitioner's brief pages 24, 25). The equation, however, is unbalanced and the analogy incorrect.

Unlike tax revenues which fund both the constitutional and non-constitutional functions of government, Small Business Administration revenues are earmarked for funding additional loans by the Small Business Administration. 15 U.S.C. 633(c).

Clearly tax revenues are of far greater significance and importance to the sovereign than Small Business Administration revenues.

It is an axiom of American jurisprudence that certain property rights are of greater importance than others and deserving of greater safeguards. As a voluntary lender with a pre-existing opportunity to evaluate credit risks, the government is not entitled to the greater safeguards afforded it as an involuntary creditor of a tax delinquent.

No decision of this court has extended the choate lien doctrine outside the area of federal tax liens. No court of appeals has yet found it necessary to employ the choate lien doctrine in determining the priority of a federal consensual security interest competing with a prior perfected security interest. *Chicago Title Insurance Co. v. Sherred Village Associates*, 568 F. 2d 217, petition for certiorari pending sub nom., *Herco-Form Incorporated v. Chicago Title Insurance Co.* (No. 77-1611), *United States v. General Doug-*

*las MacArthur, Sr. Village, Inc.*, 470 F. 2d 675, cert. den. sub nom, *County of Nassau v. United States*, 412 U.S. 922, *United States v. Ringwood Iron Mines*, 251 F. 2d 145, *H. B. Agsten & Sons, Inc. v. Huntington Trust & Savings Bank*, 388 F. 2d 156, cert. den. 390 U.S. 1025, *United States v. County of Iowa*, 295 F. 2d 257, *Willow Creek Lumber Company, Inc. v. Porter County Plumbing & Heating, Inc.*, 572 F. 2d 588, *United States v. Latrobe Construction Co.*, 246 F. 2d 357, cert. den. 355 U.S. 890, *Southwest Engine Co. v. United States*, 275 F. 2d 106, *Director of Revenue, State of Colorado v. United States*, 392 F. 2d 307, *T. H. Rogers Lumber Co. v. Apel*, 468 F. 2d 14. In each of the foregoing cases the federal lien had arisen prior to the lien or liens with which it was competing, and in each instance the federal lien was competing with a non-consensual lien acquiring an artificial priority not determined by a notice filing system.

Other courts have recognized the impropriety of extending the choate lien doctrine outside the area of federal tax liens. *Hammer v. Chapin*, 256 F. Supp. 818, *Ault v. Harris*, 317 F. Supp. 373, affirmed 432 F. 2d 441 and *United States v. California-Oregon Plywood, Inc.*, 527 F. 2d 687.

The choate lien doctrine is a doctrine of limited applicability which was designed to protect property interests of particular significance to the sovereign. No valid policy considerations exist for extending the choate lien doctrine beyond the limited circumstances and policies which have necessitated its application.

In 1966 Congress limited and severely restricted the application of the choate lien doctrine in the area of federal tax liens, Federal Tax Lien Act of 1966, the only area that this court has held the doctrine applicable to outside the context of the federal insolvency priority statute.

The extension of the choate lien doctrine beyond the area of federal tax liens has been the subject of significant criticism by legal commentators. Plumb, *Federal Liens and Priorities — Agenda for the Next Decade*, 77 Yale Law Journal 228, (1967); 2 G. Gilmore, *Security Interests in Personal Property* Sections 40.3 to 40.6 (1965); Kennedy, *The Pernicious Career of the Inchoate and General Lien*, 63 Yale Law Journal 906 (1954); Kennedy, *From Spokane County to Vermont: The Campaign of the Federal Government Against The Inchoate Lien*, 50 Iowa Law Review 755 (1965).

In the absence of a statute or decision by this court to the contrary, the court of appeals correctly determined that Kimbell was "first in time" by looking to the priority of perfection under the Uniform Commercial Code and in refusing to create a rule of law based upon the misapplication of the choate lien doctrine.

**B. "A Uniform and Certain Means Exists to Determine Lien Priorities in the Area of Government Liens Arising From Consensual Lending Activities"**

The Uniform Commercial Code was created as a series of model laws establishing rights and obligations between parties involved in commercial transactions. It has been recognized as being "... on its way to becoming a truly national law of commerce, . . . more complete and more certain than any other which can conceivably be drawn from the sources of 'general law' . . . and . . . when the states have gone so far in achieving the desirable goal of a uniform law governing commercial transactions it would be a distinct disservice to insist on a different one for the segment of commerce important but still small in relation to the total, consisting

of transactions with the United States," *United States v. Wegematic Corp.*, 360 F. 2d 676.

Article 9 of the Uniform Commercial Code which governs rights and obligations between a debtor and competing creditors has been enacted with minor variations in 49 states as well as the District of Columbia. In order to provide competing creditors of a debtor with sufficient information to determine the priority of their security interests and evaluate their security risks, each state maintains a notice filing system as a part of their public records. These notice filing systems serve the principle that as between voluntary creditors the "first in time" should prevail, the same principle which has been a companion doctrine to the choate lien doctrine.

The choate lien doctrine was created at a time when there was no uniform national notice filing system for determining relative priorities among consensual competing creditors, and was applied to liens of a peculiarly local nature, whose priority was not governed by a uniform notice filing system.

The court of appeals has recognized the reliance of the commercial world on Article 9 of the Uniform Commercial Code and its provisions governing notice filing systems and has correctly applied it as the appropriate means for determining priorities between competing consensual creditors.

Since its inception, the provisions of Article 9 have become increasingly uniform as time and judicial interpretation have led to established expectations among parties whose affairs are governed by its provisions and whose contractual expectations are drafted in accordance with its rules.

The choate lien doctrine, on the contrary, has evolved from the reversal of decisions of lower courts in which it was mis-

applied. *United States v. Pioneer American Insurance Co.*, 374 U.S. 84, *United States v. R. F. Ball Construction Co., Inc.*, 355 U.S. 587 (per curiam), *United States v. Vorreites*, 355 U.S. 15 (per curiam), *United States v. Colotta*, 350 U.S. 808. It is supported by a relatively small and incomplete body of precedent and its application outside the context of the federal insolvency priority statute has resulted in differing standards. *United States v. City of New Britain*, 347 U.S. 81, *United States v. Vermont*, 377 U.S. 351.

To reject the established provisions of the Uniform Commercial Code directly applicable to the affairs of lenders and borrowers, in favor of an inapplicable and uncertain doctrine would be illogical in itself. However, other compelling considerations dictate against the adoption of the choate lien doctrine in this instance.

Were the choate lien doctrine held to be applicable in instances such as this, then non-government, secured and perfected lenders would face the prospect that their security could be defeated by the later acquisition of a junior security interest by the federal government either directly or by assignment. The ramifications of that prospect would extend throughout commerce, upsetting the stability and uniformity in lending transactions established by Article 9 of the Uniform Commercial Code, and altering the contractual expectations of debtor and lender alike. One foreseeable result would be a severe curtailment of credit by the non-government lending sector and attendant severe economic dislocation.

This court in *Aquilino v. United States*, 363 U.S. 509 endorsed the principle that if a state does not recognize a property interest in a debtor sufficient to sustain a lien, that no lien can attach, in effect recognizing that the choate lien doctrine should be governed by the right of the states to

define the existence of property interests. Were the choate lien doctrine held to be applicable in determining priorities between competing consensual lenders, then creditors with a prior perfected security interest could be divested of those property interests by a federal doctrine which purports not to interfere with state-created property interests. Such a holding would be in conflict with this court's construction of the perimeters of the choate lien doctrine recognized in *Aquilino v. United States*, *supra*.

Any questions of priority left unresolved by the application of the Uniform Commercial Code in this instance by the court of appeals would be insignificant in comparison to the unresolved questions of priority which would come into existence were the choate lien doctrine to be extended to instances such as this.

The Small Business Administration in receiving its revenues from a broad base of consensual debtors is in a better position to self-insure its rights than are private parties for some of whom the failure of even a single major debtor may be ruinous. "It is hardly sound government policy to attempt to bolster the economy by federal loans and guarantees and at the same time to discourage uninsured credit by making it more hazardous." MacLachlan, *Improving the Law of Federal Liens and Priorities*, 1 B.C. Ind. and Com. L. Rev. 73, 74-76 (1959).

The Small Business Administration suffers no prejudice or burden by being required to examine the notice filing systems in effect throughout the United States. Indeed such examination is indispensable to a determination of whether a Small Business Administration loan is "of such sound value or so secured as reasonably to assure repayment", 15 U.S.C. 636(a) (7), and such requirement may be viewed as indicative of an intent that the Small Business

Administration function no differently than other commercial lenders. Should the Small Business Administration then find a creditor senior to itself, it can request subordination and if subordination is not forthcoming, then determine whether the loan is appropriate within the meaning of 15 U.S.C. 636(a) (7).

## II. KIMBELL'S SECURITY INTEREST IS SUFFICIENTLY CHOATE TO PREVAIL OVER THE SMALL BUSINESS ADMINISTRATION'S SECURITY INTEREST

The security interests of Kimbell Foods, Inc. were duly perfected in accordance with state laws patterned after Article 9 of the Uniform Commercial Code. Notice of those security interests had been duly filed by 1968, prior to the loan by Republic National Bank of Dallas to O.K. Super Markets in 1969.

At any given instant that security interest was fully choate within the perimeters of the choate lien doctrine as established by *United States v. City of New Britain*, 347 U.S. 81.

It is undisputed that Kimbell Foods, Inc. was reflected of record as claiming a security interest in the assets which are the subject matter of this controversy prior to any Small Business Administration involvement with O. K. Super Markets.

The certainty of a debt varies with the nature of the debt. Accordingly the certainty of different debts is established in different manners. Unlike varying statutory liens which may or may not be established prior to judgment depending upon when various elements of such debts are established, at any given instant the debt of O. K. Super

Markets to Kimbell Foods, Inc. was a fixed liquidated sum established by the difference between the aggregate of the sums advanced by Kimbell Foods, Inc. to O. K. Super Markets and the aggregate repayments by O. K. Super Markets to Kimbell Foods, Inc.

### CONCLUSION

In light of the policy considerations which have limited the applicability of the choate lien doctrine and in recognition of both the judicial and legislative policies which have led to its curtailment outside the context of federal tax liens, the court of appeals correctly employed the Uniform Commercial Code in this instance to determine the relative priority of competing consensual security interests, one held by the federal government by virtue of an assignment from a non-government commercial lender, and the other by a non-government commercial lender. The judgment of the court of appeals should be upheld.

Respectfully submitted,

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